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SUBJECT: SECRETARY PAULSON SPEAKS AT INDIAN INFRASTRUCTURE CONFERENCE
HIGHLIGHTING INVESTMENT POTENTIAL

11. (U) Summary: At an Infrastructure Conference in Mumbai on October 29, 2007, visiting U.S. Treasury Secretary Paulson encouraged continued economic reforms in India, especially transparent and independent regulatory frameworks. He underscored India's need to develop a domestic corporate bond market to facilitate long-term investment in infrastructure. Indian Finance Minister Chidambaram said India needs to raise infrastructure investment from 5% to 9% of GDP over the next five years or to about \$488 billion, with private sector investment opportunity in India's infrastructure estimated at around \$150 billion. In addition to promising to broaden and deepen the bond market, the Finance Minister invited US companies to participate in the current bidding for the 'ultra mega power projects.' Despite these welcoming comments, and a recognition of the great opportunities in infrastructure investments, U.S. investors are still concerned about political and economic risk and project implementation. End Summary.

U.S. and Indian Government Officials Emphasize India's Urgent
Need for Infrastructure

12. (U) On October 29, 2007, Secretary Paulson and 30 U.S. firms participated in a conference in Mumbai to highlight investment opportunities in India's infrastructure. Organized by the US-India CEO Forum, the Infrastructure Investment Conference was attended by CEOs of some of the largest Indian companies as well as senior Government of India (GOI) officials, including Finance Minister P. Chidambaram and Deputy Chairman of the Planning Commission Montek Singh Ahluwalia. In his speech, Secretary Paulson emphasized the need to improve India's financial infrastructure and expressed support for developing Mumbai into an International Financial Center (IFC). Urging the Indian government to continue opening and liberalizing the economy, he underscored India's need to develop a domestic corporate bond market to facilitate long-term investment in physical infrastructure. The Secretary also highlighted the USG's commitment to the civil-nuclear deal as an avenue for India to obtain clean energy. The Secretary emphasized that a Doha agreement is within reach, and the single greatest beneficiary

will be the Indian people. He concluded his remarks by pledging to continue working with his Indian counterparts to limit protectionist sentiment in U.S. and India.

13. (U) In his remarks, Finance Minister Chidambaram noted that India needed to develop its lagging infrastructure to achieve and sustain its continued growth. According to Chidambaram, India needs to raise infrastructure investment from 5% to 9% of GDP over the next five years. This is equal to \$488 billion over five years with roughly 30% of that expected to be financed by the private sector. He admitted that the regulatory process could be improved, as some dedicated infrastructure funds have been held up, not for lack of funds but rather for a lack of projects.

Finance Minister Defends Slow Capital Liberalization and Legal Process

14. (U) In the Question and Answer session, Finance Minister Chidambaram defended India's slow-moving capital market liberalization process. He maintained that capital market reforms were being carried out at a slow pace to avoid shocks and to prevent irreversible mistakes "that the Indian economy cannot afford." He noted that several Western pension funds, including CALPERS and the Norwegian national pension fund, and insurance funds were already investing in the Indian capital

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markets. All registered funds are free to invest in India, he continued. The Finance Minister added that the government is only concerned about inflows made by unregistered entities, or coming from un-regulated countries. Asked about the dollar's global depreciation, Secretary Paulson declared that a strong dollar is in the U.S. national interest and the market should set the value of the currency. The Secretary emphasized that India has let the market determine its currency rate and kept inflation low as a result; his focus has been on China which has not let its currency appreciate. He noted that economic reforms have continued for the past 15 years in India, regardless of the government in power.

15. (U) Responding to a question about the transparency of the dispute resolution process in India, Chidambaram offered a surprisingly strong defense of India's judicial process, comparing it favorably to those of the U.S. or the U.K. He noted that India was one of a few countries which recognized "rule of law" and which had an "independent and well-functioning judiciary." He assured the audience that there was no need to feel that their disputes would not be resolved, adding that India's arbitration system is "as good as any in the world." Arbitration is conducted by a panel of international arbitrators from Singapore, Hong Kong and London. The Finance Minister added that India recognizes foreign awards and those awards are enforceable in India. He specifically mentioned the Dabhol power plant case from 1998, saying that it was resolved by 2005. Chidambaram said he was told that it could have taken an even longer time to resolve a similar case in the U.S. or the U.K.

16. (U) Questioned about the corporate bond market, Chidambaram acknowledged that India had fallen behind in developing a corporate bond market. He noted that, at present, the bond market represents less than 1% of India's GDP, trading volumes are insignificant, and process of issuance and clearing trades is cumbersome. He said that he "has a list of things" that are

in process of being implemented to broaden and deepen the bond market.

17. (U) One audience member suggested to Secretary Paulson that an independent and equidistant regulator be created to address the needs of all three stakeholders in a public/private partnership: the public sector, the private sector and the consumer. Secretary Paulson pointed out that in sectors where government entities act as both regulator and providers of financial services, independence is difficult to achieve, making it difficult to attract private sector investment. The Secretary suggested that greater regulatory dialogue between

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American and Indian regulators was a possibility. He highlighted the need for transparent and independent regulatory frameworks that are moving towards global consistency and mutual recognition.

18. (U) In the following session chaired by Mukesh Ambani, Chairman of Reliance Industries Limited, Montek Singh Ahluwalia addressed the current state of India's development (Note: His address drew on themes expressed in an interview with McKinsey that has been published at the following weblink:

<http://www.livemint.com/2007/11/05002031/8216We8217re-clearly-hea.html>). Al Hubbard, the Director of the U.S. National Economic Council, discussed the strong and strengthening U.S.-India relationship, touching on defense, the environment and Doha as areas where further progress could be made. He also pressed for action with regards to the civil nuclear accord, stating the window to complete the deal is closing. Asked about infrastructure development in the U.S., Hubbard noted that U.S. has its own challenges in ensuring transparency; in particular, he pointed out that some companies have tried to lobby Congress to change the winning bidder for certain projects. Asked

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whether, the government had too large of a hand in infrastructure development, Ahluwalia replied that infrastructure development is being done in different ways in different states and in different sectors. In particular, he noted that the development of "minor" ports had been deregulated in order to introduce competition with the "major" ports, which remain regulated by the central government.

Poor Response for GOI-touted Ultra-Mega Power Projects

19. (U) During the Question and Answer session, Finance Minister Chidambaram conveyed that for the four 4000MW "ultra mega power projects (UMPP)," bidding had been aggressive. However, the Finance Minister expressed surprise that U.S. companies had not bid on these projects. He specifically invited U.S. companies to participate in either the construction or financing of these projects. The innovative financing methodology that these companies could bring would bring down the cost of power, he maintained. In a separate panel discussion, Sanjay Reddy, of the GVK Group, explained the lack of interest in these ultra mega power projects. He observed that the power sector requires large capital investments, but are risky due to the political environment surrounding them. (Note: His group did not bid on UMPPs despite experience in building power plants.). Responding to an American investor's question about project delays, Reddy noted that this is largely due to a lack of large construction companies in India.

¶10. (U) At a session of the leading bureaucrats from four Central Government ministries- Civil Aviation, Urban Development, Power, and Road Transport - each emphasized that projects in their respective sector were open to investment by domestic and foreign investors. Responding to a questioner who termed the UMPPs to be "Soviet Style," Anil Razdan, Secretary of the Ministry of Power, informed the audience that these projects were inspired by China's recent build-out of power capacity. He spoke admiringly of how the Chinese added 100,000 MW of power capacity last year while India's total power capacity is about 120,000 MW.

Enormous Opportunities for U. S. Investment

¶11. (U) During a panel discussion of Indian infrastructure companies, Rajiv Lall of IDFC said that there is an acute shortage of infrastructure services and that U. S. companies could make large returns on investment by providing infrastructure services to Indian companies. He also noted that Indian entrepreneurs have an advantage over international entrepreneurs mainly due to an "information asymmetry." There is a golden opportunity for smart financial capital from overseas to team up with this domestic talent, given the depth and quality of Indian entrepreneurial talent and management expertise, he added. In a separate session chaired by James Lambright, Chairman of the U.S. Export-Import Bank, leading American institutional investors - Richard Frank of Darby Overseas Investment, Joseph Azelby of JP Morgan, Emil Hendry of Lehman Bros, and Tracy Wolstencroft of Goldman Sachs - all concurred with Lall and said they would prefer to partner with local entrepreneurs and leverage on their talent, skill and knowledge of local conditions. They added that no international company could think of not investing in India, given its strong economic fundamentals and the size of its market. They emphasized that "a wall of money" was ready to invest in Indian infrastructure if more projects were approved.

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¶12. (U) During the closing session of the conference, B.K. Chaturvedi, a member of the Planning Commission, contradicted the remarks of the Finance Minister by stating that, from his perspective, he saw more projects than investment capital. When pressed about this point from the audience, he emphasized that major institutions, like the Wall Street investors who had spoken earlier, seemed to be looking only at large projects; there are many smaller projects that have not come on the radar of these investors, he said. He admitted, however, that in the recent past, project scopes were not up to international standards but he thought that this problem had been corrected. Dinesh Chandiok of Tata Realty and Infrastructure noted that the more pressing need was to develop urban infrastructure. The added pressure on urban infrastructure due to the increasing migration from rural to urban areas and the lack of investment in urban infrastructure has created a "mismatch between the quality of life demanded and what is available," he added.

¶13. (U) Comment. This Infrastructure Conference was useful in highlighting the many areas where U.S. and Indian investors and officials agree - and disagree - on infrastructure investment opportunities in India. All participants agreed on India's strong economic fundamentals, and the need for massive infrastructure investment, as well as regulatory changes that would attract this investment, such as those that would create a

broader, deeper corporate bond market. However, there is a disconnect between U.S. investors and the Indian government on the utility of India's dispute resolution and arbitration system, as well as risk assessments for large projects like the ultra-mega power projects. While the UMPPs are an essential part of the Indian government's infrastructure strategy, U.S. investors so far have shown little interest in these "Soviet style" projects. Considering the GOI's dismal record in implementing large infrastructure projects, post believes that the percentage of India's infrastructure needs that come from public/private partnerships should be much higher than the projected 30 percent. The recent quarterly report by the GOI's Ministry of Statistics and Program Implementation suggests that out of a total of 866 public infrastructure projects, across 13 ministries, 218 have no specified completion date and another 297 are running badly behind schedule - over 16 years in extreme cases. The Ministry estimates that delays have increased project costs by 37%.

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